

L. William Seidman
1025 Connecticut Ave., NW
Suite 1008
Washington, DC 20036
(202) 530-0910

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Alfred Pollard, Esq.
General Counsel
Office of Federal Enterprise Oversight
700 G Street, N.W., Fourth Floor
Washington, D.C. 20552

RE: Risk-Based Capital Proposal + Comments on the Comments

Dear Mr. Pollard:

I appreciate the opportunity OFHEO has afforded the public to comment both on OFHEO's risk-based capital proposal, and to comment on the comments various parties have submitted on that proposal. I hope that OFHEO will find my views and observations below to be helpful in developing a final risk-based capital regulation.

Operational Workability

Freddie Mac has asked me to review the option it described to address operational workability and to provide a regulator's perspective. Specifically, Freddie Mac described the option of OFHEO specifying the stress test and for that stress test to be applied by adapting existing, production-quality Enterprise systems that already perform data, cash flow and accounting functions for comparable purposes (*e.g.*, to forecast earnings), as an interim or permanent solution. The Enterprises then would report their stress test results to OFHEO quarterly. This option stands in contrast to the alternative of OFHEO fully specifying both the stress test and the infrastructure necessary to apply the test, and of OFHEO alone applying the test using its infrastructure.

I believe that, in today's environment, the most cost effective approach to prudential oversight will have the regulator tap into the systems and processes an institution relies upon to inform its own business decisions, rather than duplicating the institution's processes. The focus of supervision and regulation + especially for the larger institutions + should be less on detail and more on the overall appropriateness of the structure of risk-management systems. That is the most efficient way to address the safety and soundness of the secondary mortgage market and the overall stability of financial markets.

In particular, I believe that OFHEO should avoid mechanical or formulaic approaches that, whether intentionally or not, effectively "lock" the Enterprises into particular technologies long after they become outmoded. Planning should be for the long pull, not for developing near-term quick fixes. In sum, it is the framework that must be right.

In my opinion, the processes and procedures outlined in Freddie Mac's comments would be an appropriate means of making the regulation workable within the vision described above for modern, efficient prudential oversight. Those processes and procedures could get the framework right by appropriately allocating the prudential oversight role to OFHEO without unnecessary duplication or locking in technologies after they have become outmoded. OFHEO should readily be able to ensure the accuracy and validity of the Enterprises' stress test results by supervising OFHEO's examination and modeling expertise.

What may be even more important from a regulator's perspective is that the option Freddie Mac describes would enable OFHEO to take prompt corrective action with confidence that the capital calculation upon which the action is based will not successfully be challenged. Under the option Freddie Mac describes, both OFHEO and the Enterprise would focus early on solving any underlying safety and soundness issue that might arise. The information would be available early in the process and the Enterprises would not be in any position to dispute the accuracy of that information. In contrast, OFHEO's track record to date suggests that, under the alternative option of OFHEO applying the stress test using its own infrastructure, OFHEO and the Enterprises could well delay focusing on any underlying problems for the considerable extra time it would take OFHEO to obtain quarterly results and to satisfy the Enterprises of the accuracy of those results.

From what I know about what government agencies are and are not good at, it seems ill advised to create a regulatory scheme where that agency's ability to act hinges on the ability of that agency, no matter how competent, to keep a complete computer system fully accurate and up to date. OFHEO should not create unnecessary vulnerability for itself nor incur the considerable cost of creating its own duplicate system. Whatever OFHEO might gain from getting into the computer software business would be overwhelmed by the corresponding loss in OFHEO's ability to quickly and surely address any safety and soundness issues that might arise. This, of course, was the conclusion of the Basle Committee when it examined this very same question in setting capital standards for international banks.

Again, I appreciate the opportunity to share my views and observations on this important subject.

Very truly yours,

[Signed: L. William Seidman]

L. William Seidman

cc: Bruce Oliver, Esquire